RESEARCH BULLETIN

Hedging Consensus

Inflation, Commodities and Momentum Strategies

ISSUE No. 1 | *Aug. 2021*

"Trend following has done well historically at times of major economic uncertainty and upheaval, as these episodes tend to be accompanied by large and prolonged shifts in asset prices across multiple sectors. While the importance of having long commodity exposure during periods of rising inflation is well understood, investors may be overlooking the potential for trends in other sectors. Currencies, for example, are a notable driver of trend following performance."

Winton Capital
Trend Following and Periods of Rising Inflation, June 2021

AUTHOR

Antolin Garza
Head of Research and Investment Solutions
Altegris

SECTOR/TOPICS

Managed Futures, Inflation Hedging, Commodities, Momentum Strategies

READ TIME

Under 5 minutes

WHAT IF INFLATION ISN'T TRANSITORY?

Today, there is a consensus view that inflation is transitory and central banks have it under control. As observers of market history, we know that market crises historically occur outside of the scope of consensus.

In light of investor concerns about persistent inflation, we re-examined the characteristics of momentum-based strategies and their ability to provide favorable outcomes in the event the consensus is wrong.

Our investment partners at Winton looked back for periods of rising inflation - defined as periods when the rolling 12-month CPI in the US increases by 4% or more from peak to trough. In **Figure 1**, the rolling CPI is the dark gray line and you can see four periods that meet that rising inflation criteria which are labeled at the top of the shaded gray areas: The Great Inflation '72-'80; Reagan Tax Cuts in '86-'90; the Commodity Super-Cycle in '02-'08; and The Great Reflation in '09-'11.

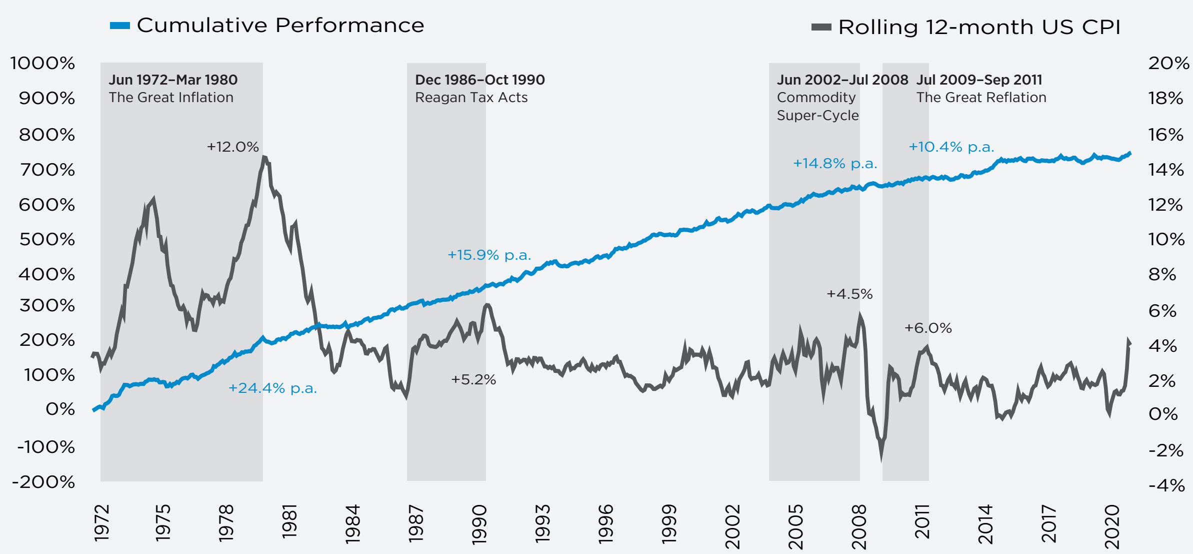
Winton applied their methodologies of momentum-based trading models to market and simulated data dating back to the 1970's and created a simulation of a systematic diversified momentum system that predates their Firm history (Winton's principal's have been developing momentum-based trading models for close to 35 years now). This simulation provides equal exposure to the four key sectors representing momentum-based strategies (equity indices, fixed income, currencies, and commodities). The simulation started with 12 markets in 1972 and ended with 117 in 2021.

Key Observations: During the four periods of rising inflation, the simulated systematic trend strategy had annualized returns of:

- 24.4% in The Great Inflation
- 15.9% in the Reagan Tax Cut era
- 14.8% in the Commodity Super-Cycle
- 10.4% in The Great Reflation

From these observations we concluded that there is ample evidence suggesting that systematic momentum-based strategies may be a formidable means to hedge an inflationary period, and in this case, the consensus.

FIGURE 1



Source: Winton Capital Management Limited, Fred, as of 31 May 2021. This simulation is shown for illustrative purposes to demonstrate how trend-following strategies work. It does not represent a simulation of a Winton product. The simulated returns show the backtested market P&Ls for the trend-following component of Winton's Diversified Macro strategy. Equal risk is allocated to the four supersectors (commodities, stock indices, fixed income and currencies) and the portfolio is geared daily to a 10% annualised volatility. Futures markets are added as and when data becomes available, with the simulation starting with 12 markets and ending with 117. Where possible, data for futures markets has been back-extended using relevant datasets (S&P 500 and Dow Jones futures back 1972, for example). The simulated figures represent the cumulative summed P&L. It does not reflect the deduction of any fees, nor does it include interest earned on cash. These results are simulated and do not represent actual trading; no representation is being made that any account will or is likely to achieve profits or losses similar to those being shown.

RISK DISCLOSURES AND OTHER IMPORTANT CONSIDERATIONS

1945280_082621